



Signed and Filed: December 17, 2007

A handwritten signature in dark ink, appearing to read "T. E. Carlson", is written over a horizontal line.

THOMAS E. CARLSON
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re)	Case No. 07-30309 TEC
)	
HUGO NERY BONILLA,)	Chapter 7
)	
Debtor.)	
)	
ATR-KIM ENG CAPITAL PARTNERS, INC.,)	Adv. Proc. No. 07-3079 TC
and ATR-KIM ENG FINANCIAL)	
CORPORATION,)	
)	
Plaintiffs,)	
)	
vs.)	
)	
HUGO NERY BONILLA,)	
)	
Defendant.)	

MEMORANDUM RE DEFENDANT'S MOTION FOR RECONSIDERATION AND
PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

I. Motion for Reconsideration

Defendant seeks reconsideration of the denial of his motion to dismiss Plaintiffs' fourth cause of action for failure to state a claim upon which relief can be granted. In so moving, Defendant

MEMO. RE DEFENDANT'S MTN
FOR RECONSID. AND PLAINTIFFS'
MTN. FOR SUMM. JUDG.

1 contends that this court made a manifest error of law in
2 determining that the director of a Delaware corporation is a
3 "fiduciary" within the meaning of section 523(a)(4) of the
4 Bankruptcy Code.

5 Defendant first argues that this court did not give proper
6 deference to the decision of the Ninth Circuit in Cal-Micro, Inc.,
7 v. Cantrell (In re Cantrell), 329 F.3d 1119 (9th Cir. 2003).
8 Because Cantrell relied upon a California Supreme Court decision
9 stating that a corporate officer is an agent rather than a trustee
10 under California law, I find Cantrell to be of little relevance to
11 the present case involving a Delaware director.

12 Defendant next argues that the decisions of the Delaware
13 Supreme Court imposing trustee-like duties on corporate directors
14 are inapposite because they involved instances in which the
15 corporation was insolvent or the director improperly benefitted
16 from the act in question. This argument is unpersuasive for two
17 reasons.

18 First, Defendant cites no Delaware decision holding that a
19 corporate director has trustee-like duties *only* where the
20 corporation is insolvent or the director benefits. At the same
21 time, a decision of the Delaware Chancery Court imposed trustee-
22 like duties on corporate directors where there was no showing of
23 insolvency or improper benefit. Bodell v. General Gas & Electric
24 Corp., 132 A. 442, 447 (Del. Ch. 1926).

25 Second, a recent decision of the Delaware Supreme Court holds
26 that the fiduciary duties owed shareholders are the same as those
27 owed creditors upon insolvency.

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MEMO. RE DEFENDANT'S MTN
FOR RECONSID. AND PLAINTIFFS'
MTN. FOR SUMM. JUDG.

1 It is well settled that directors owe fiduciary
2 duties to the corporation. When a corporation is
3 *solvent*, those duties may be enforced by its
4 shareholders, who have standing to bring *derivative*
5 actions on behalf of the corporation because they are the
6 ultimate beneficiaries of the corporation's growth and
7 increased value. When a corporation is *insolvent*,
8 however, its creditors take the place of the shareholders
9 as the residual beneficiaries of any increase in value.

6 Consequently, the creditors of an *insolvent*
7 corporation have standing to maintain derivative claims
8 against directors on behalf of the corporation for
9 breaches of fiduciary duties. The corporation's
10 insolvency "makes the creditors the principal
11 constituency injured by any fiduciary breaches that
12 diminish the firm's value." Therefore, equitable
13 considerations give creditors standing to pursue
14 derivative claims against the directors of an insolvent
15 corporation. Individual creditors of an insolvent
16 corporation have the same incentive to pursue valid
17 derivative claims on its behalf that shareholders have
18 when the corporation is solvent.

13 North American Catholic Educational Programming Foundation, Inc.,
14 v. Gheewalla, 930 A.2d 92, 101-02 (Del. 2007) (emphasis and
15 quotations in original)(footnotes omitted). In this context, the
16 Delaware decisions holding that directors become trustees for
17 creditors upon insolvency become direct support for the conclusion
18 that directors are trustee for shareholders while the corporation
19 is solvent.

20 Defendant argues finally that this court erred in relying upon
21 the "substantially similar" test stated in Lewis v. Scott (In re
22 Lewis), 97 F.3d 1182 (9th Cir. 1996), asserting that Lewis is an
23 "anomaly" among Ninth Circuit decisions otherwise interpreting
24 section 523(a)(4) very narrowly. This court is persuaded that the
25 functional approach of Lewis is sound. Reliance on formalistic
26 taxonomy has lead the Ninth Circuit to the somewhat curious
27 conclusion that a director of a California corporation is a
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MEMO. RE DEFENDANT'S MTN
FOR RECONSID. AND PLAINTIFFS'
MTN. FOR SUMM. JUDG.

1 fiduciary for creditors when the corporation is insolvent,¹ but is
2 not a fiduciary for the director's prime constituents,
3 shareholders, when the corporation is not insolvent.² North
4 American Catholic, decided by the court most widely recognized for
5 its expertise in corporate governance, suggests that a functional,
6 interest-based approach is appropriate for any analysis of the
7 fiduciary duties of a director under Delaware law.

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9 II. Plaintiffs' Motion for Summary Judgment

10 Plaintiffs seek summary judgment on their fourth cause of
11 action based on the preclusive effect of the Chancery Court
12 judgment. Defendant contends that issue preclusion is
13 inappropriate because the factual issues relevant to the fourth
14 cause of action are not identical to those decided in the state-
15 court action. This argument is unpersuasive.

16 This court having decided that Defendant is a "fiduciary" as a
17 matter of law, the relevant fact question under section 523(a)(4)
18 is whether his wrongful acts amounted to a "defalcation." The
19 state court made detailed findings to the effect that Defendant
20 consciously failed to take the minimum steps legally required of
21 him as a director to protect corporate assets. These findings
22 represent a finding of defalcation: Defendant, while acting in a
23 fiduciary capacity was unable to account for property placed under
24

25 ¹ Lawrence T. Lasagna, Inc. v. Foster, 609 F.2d 392, 396 (9th
26 Cir. 1979) (director of insolvent corporation organized under
27 California law is fiduciary for purposes of section 35(a)(4),
predecessor to section 523(a)(4)); Nahman v. Jacks (In re Jacks),
266 B.R. 728, 737 (9th Cir. BAP 2001).

28 ² Cantrell, 329 F.3d at 1127.

1 his charge, and the property was lost due to Defendant's failure to
2 follow the instructions imposed upon him by law regarding the
3 protection of that property. See Otto v. Niles (In re Niles), 106
4 F.3d 1456, 1460-62 (9th Cir. 1997).

5 ****END OF MEMORANDUM****

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MEMO. RE DEFENDANT'S MTN
FOR RECONSID. AND PLAINTIFFS'
MTN. FOR SUMM. JUDG.

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